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## **ENSURING COMPLIANCE WITH THE PAYCHECK PROTECTION PROGRAM (PPP)**

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law. The CARES Act created the Paycheck Protection Program (PPP), authorizing the U.S. Small Business Administration (SBA) to administer \$349 billion in forgivable loans to small businesses adversely affected by the Coronavirus pandemic. Faced with overwhelming demand, Congress allocated more than \$300 billion in additional PPP funding, for a total of \$659 billion.

PPP loans have provided a crucial lifeline to businesses struggling to stay afloat due to the Coronavirus pandemic. Consequently, federal authorities have made it a priority to root out – and prosecute – fraud and abuse of the PPP. PPP loan applicants must be vigilant to ensure their compliance with the PPP’s requirements. This *Client Alert* provides an overview of the PPP’s requirements, describes ongoing PPP-related prosecutions, and recommends best practices in seeking and using PPP loan funds.

### **Applying for PPP Loans <sup>1</sup>**

The PPP provides incentives for eligible small business owners to keep employees on their payroll, offering forgivable loans of up to \$10 million. A business is eligible for a PPP loan if it:

1. Has 500 or fewer employees whose principal place of business is in the United States, or otherwise meets the SBA’s industry size standard for its industry; and
2. Was in operation on February 15, 2020 and had employees for whom it paid salaries and payroll taxes or paid independent contractors.

Sole proprietors, independent contractors, and otherwise eligible self-employed persons in operation on February 15, 2020 also are eligible to apply for PPP loans.

In addition to certifying eligibility for a PPP loan, a PPP loan applicant must assess its economic need and certify, in good faith, that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant.” The SBA will review all PPP loans that exceed \$2 million – as well as other loans “as appropriate” – to assess whether the loan applicant had an adequate basis for making this certification. If the SBA finds that there was no adequate basis, the SBA will seek repayment of the outstanding PPP loan balance and inform the lender that the small business is not eligible for loan forgiveness. If the small business repays the loan, the SBA will not pursue

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1. The SBA’s Interim Final Rule interpreting the CARES Act sets forth detailed guidelines concerning PPP eligibility, the PPP loan application process, and PPP administration and oversight. The SBA’s Interim Final Rule, effective April 15, 2020, is accessible at <https://www.govinfo.gov/content/pkg/FR-2020-04-15/pdf/2020-07672.pdf>.

administrative enforcement or refer the matter to other agencies, such as the IRS. If, however, a PPP loan recipient had no adequate basis for making this certification or knowingly used PPP funds for unauthorized purposes, it and its owners might be subject to liability – including criminal fraud charges.<sup>2</sup>

### **PPP Loan Forgiveness**

The SBA will forgive a PPP loan, including any accrued interest, to the extent that the disbursed funds are used for (a) payroll costs, (b) costs to continue group health benefits during periods of paid sick, medical, or family leave, (c) interest on mortgage obligations, (d) rent payments, (e) utility payments, (f) interest payments on any other debt obligation incurred before February 15, 2020, or (f) refinancing Economic Injury Disaster Loans made by the SBA between January 31, 2020 and April 3, 2020.

A PPP loan recipient must use at least 75% of the PPP loan for payroll costs. “Payroll costs” include, among other things, (a) compensation to employees who reside in the United States, including salary, wages, commissions, and other like compensation, (b) payment for vacation, parental, family, medical, or sick leave, and (c) payment of state and local taxes assessed on employees’ compensation. “Payroll costs” exclude, among other things, (a) compensation to employees who reside outside of the United States, and (b) compensation to employees who have annual salaries that exceed \$100,000.

The SBA will reduce a small business’s loan forgiveness if its full-time headcount declines, or if its employees’ salary levels decrease. If a PPP loan recipient does not use its PPP loan for permitted purposes, the recipient and its owners also could be subject to criminal liability.

### **Consequences of Non-Compliance with PPP Requirements**

In March 2020, Attorney General Barr directed all U.S. Attorneys to prioritize the investigation and prosecution of fraud schemes related to the Coronavirus pandemic.<sup>3</sup> Federal law enforcement already has heeded this call, commencing various criminal prosecutions relating to misuse and abuse of the PPP.

For example, on May 5, 2020, the U.S. Attorney’s Office in Rhode Island charged two individuals with fraudulently seeking more than \$500,000 in forgivable PPP loans. In their PPP loan applications, they claimed to control four business entities with dozens of wage-earning employees. In reality, none of the business entities had any employees, none of the business entities was in operation as of February 15, 2020, and, in one instance, the loan applicant did not own the business entity. Even though the SBA had not yet disbursed any PPP loan funds, these individuals were charged with conspiracy to commit bank fraud and conspiracy to make false statements to influence the SBA, among other charges.<sup>4</sup>

As another example, on May 13, 2020, the U.S. Attorney’s Office in Atlanta, Georgia arrested and charged a reality television star with bank fraud charges arising from his PPP loan. He had certified in his PPP loan application that he would use the PPP loan proceeds “to retain workers and maintain payroll or make mortgage interest payments, lease payments, and utility payments, as specified under

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2. See SBA and U.S. Department of the Treasury Paycheck Protection Program Loans Frequently Asked Questions (FAQs), dated as of May 27, 2020 (the “FAQs”), at Nos. 31, 39, and 46. The FAQs are accessible at <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>.

3. Press Release: Attorney General William P. Barr Urges American Public to Report COVID-19 Fraud, dated March 20, 2020, accessible at <https://www.justice.gov/opa/pr/attorney-general-william-p-barr-urges-american-public-report-covid-19-fraud>.

4. *United States v. Butziger*, Case No. 1:20-mj-00033-LDA-1 (D.R.I.); *United States v. Staveley*, Case No. 1:20-mj-00034-LDA-1 (D.R.I.); see Press Release: Two Charged in Rhode Island with Stimulus Fraud, dated May 5, 2020, accessible at <https://www.justice.gov/opa/pr/two-charged-rhode-island-stimulus-fraud>.

the [PPP] Rule,” and received a \$2 million PPP loan. However, instead of using the funds for permitted purposes, he spent more than \$1.5 million on jewelry, a luxury car, and child support payments.<sup>5</sup>

Most recently, on May 21, 2020, the U.S. Attorney’s Office in New York City announced the arrest of a Chinese national residing in Manhattan for a fraudulent scheme to obtain more than \$20 million in PPP loans. This individual falsely represented to the SBA and to five financial institutions that he was a United States citizen, that his companies had hundreds of employees, and that he paid millions of dollars in wages. In actuality, he was not a United States citizen and was his companies’ only employee. In addition, one of his companies falsely stated that it was representing New York State in procuring Coronavirus test kits and personal protective equipment. He was charged with bank fraud, making false statements to a bank, and major fraud against the United States, among other charges.<sup>6</sup>

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As illustrated by ongoing PPP-related prosecutions, small businesses must take great care to confirm their eligibility for a PPP loan, confirm the accuracy of the certifications in their PPP loan applications and any other documentation submitted to the SBA, and ensure that they use PPP loan proceeds for proper purposes. PPP loan applicants must prepare for scrutiny by the SBA, the IRS, and other oversight bodies – even if the requested loan amount is small – by assembling and preserving payroll records, bank records, tax records, insurance records, financial statements, any other documentation supporting the representations made in their PPP loan applications, and any other documentation regarding their use of PPP loan proceeds. We encourage small businesses considering applying for a PPP loan to consult with legal counsel to assess their eligibility, guide them through the application process, and advise them as to any changes to the PPP. Fox Horan & Camerini LLP stands ready to assist small businesses with any PPP-related inquiry.

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5. *United States v. Fayne*, Case No. 1:20-mj-00370-JSA (N.D. Ga.); see Press Release: Reality TV Personality Charged with Bank Fraud, dated May 13, 2020, accessible at <https://www.justice.gov/usao-ndga/pr/reality-tv-personality-charged-bank-fraud>.

6. *United States v. Ma*, Case No. 20-mag-5202 (S.D.N.Y.); see Press Release: Chinese National Arrested for \$20 Million Scheme to Fraudulently Obtain Loans Intended to Help Small Businesses During COVID-19 Pandemic, dated May 21, 2020, accessible at <https://www.justice.gov/usao-sdny/pr/chinese-national-arrested-20-million-scheme-fraudulently-obtain-loans-intended-help>.